BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
INDUSTRIAL MANAGEMENT CORPORATION)

Appearances:

For Appellant: Henry C. Diehl, Attorney at Law

For Respondent: John S. Warren, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Industrial Management Corporation to proposed assessments of additional franchise tax in the amounts of $47.77, $656.73, $812.65 and $1,797.76 for the income years 1946, 1947, 1948 and 1949, respectively. Since the filing of this appeal, the Franchise Tax Board has conceded that certain overhead expenses should be apportioned in a manner advocated by Appellant, thus eliminating the proposed assessment for the income year 1946 and reducing the remaining proposed assessments to $257.04, $789.19 and $1,511.93 for the income years 1947, 1948 and 1949, respectively.

Appellant is a California corporation which, during the years involved, was engaged in holding and selling street improvement bonds, in renting real estate and in manufacturing and selling operations. Its activities in connection with the street improvement bonds and real estate were conducted entirely within California. Its manufacturing operations were conducted both within and without this State. All of these activities were directed from Appellant's principal office in Los Angeles, California. Appellant's bond and real estate activities were profitable, but the expenses of the manufacturing operations exceeded the income from those operations.

In making its determination, the Franchise Tax Board attributed all of the net income from the bond and real estate operations to California. It allocated a part of the net losses from the manufacturing operations to this State in accordance with the California portion of the property, payroll and sales of the manufacturing operations. It then deducted the California share of the losses as so computed from the net income of the bond and real estate operations to arrive at the net inccae of Appellant which was subject to tax in this State.

Appellant contends that its entire business was unitary in nature and that, since its over-all operations resulted in losses, it is improper to assign any net income to California. In the alternative, it contends that the entire net losses from its manufacturing division rather than an allocated share of the losses must be deducted from the net income from its other activities. In support of this contention, it argues that Section 10 of the Bank and Corporation Franchise Tax Act does not permit an allocation within and without the State if net income is not derived from outside of the State.

Section 10 of the Bank and Corporation Franchise Tax Act (now Section 25101 of the Revenue and Taxation Code) provided:

> When the income of the bank or corporation is derived from or attributable to sources both within and without the State, the tax shall be measured by the net income derived from or attributable to sources within this State. Such income shall be determined by an allocation upon the basis of sales, purchases, expenses of manufacture, pay roll, value and situs of tangible property or by reference to any of these or other factors or by such other method of allocation as is fairly calculated to determine the net income derived from or attributable to sources within this State. Income from business carried on partly within and partly without this State shall be allocated in such a manner as is fairly calculated to apportion such income among the States or countries in which such business is conducted ..."

A business is considered unitary, requiring the combination of the entire income therefrom and the allocation of that income within and without the State by an appropriate formula, if the operations within the State depend upon or contribute to the operations out of the State (Edison California Stores, Inc. v. McColgan, 30 Cal, 2d 472). "If there is no such relationship, then the business in the state may be considered separate and the income therefrom may be determined without reference to the success or failure of the taxpayer% activities in other states." (Altman and Keesling, Allocation of Income in State Taxation, 2d Ed., p. 101.)

Appellant's position that its entire operations were unitary is based solely upon an allegation that all of the

operations were directed from its principal office, We do not know the nature of the manufacturing operations, except that those operations included the manufacture of insecticides. We cannot find from these facts that the bond and real estate activities depended upon or contributed to the manufacturing activities. The action of the Franchise Tax Board in determining the net income from the bond and real estate activities separately from the net income from the manufacturing activities, and in assigning the former entirely to California, accordingly, must be sustained.

Wit-h-respect to Appellant's alternative contention, Section 10 (supra) by its initial terms operated when income is derived from sources within and without the State. The section then provides that the tax shall be measured by the net income from California and that such net income shall be determined by a "fairly calculated" method. Appellant did derive income from sources within and without the State. In determining the net income from California sources, there is no more reason for assigning all of the deductible expenses to California than there is for assigning them all outside of the State. So far as we can determine from the facts before us, the method used by the Franchise Tax Board, that is, apportioning the net loss from the manufacturing operations within and without the State and deducting the California portion of the loss from the income of the bond and real estate operations, was fairly calculated to determine the net income from California sources.

Appellant has also claimed that the method used by the Franchise Tax Board is unconstitutional in that it results in a tax measured by net income exceeding the net income from all sources, Section 10 (supra) provides that the tax shall be measured by net income from California. Losses incurred out of the State are not material in determining such income. In accordance with our well established policy, we will not determine the constitutionality of a statute in an appeal involving unpaid assessments, since a finding of unconstitutionality could not be reviewed by the courts (see Appeal of Tide Water Associated Oil Co,, decided June 3,1948).

ORDER

Pursuant to the views expressed in the Opinion of the Board on file in this proceeding, and good cause appearing therefor,

Appeal of Industrial Management Corporation

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of Industrial Management Corporation to proposed assessments of additional franchise tax in the amounts of $47.77, $656.73, $812.65, and $1,797.76 for the income years 1946, 1947, 1948 and 1949, respectively, be and the same is hereby modified as follows: The proposed assessment for the income year 1946 is eliminated and the remaining proposed assessments are reduced to $257.04, $789.19 and $1,511.93 for the income years 1947, 1948 and 1949, respectively.

Done at Sacramento, California, this 9th day of June, 1959, by the State Board of Equalization,,

Paul R, Leak.2 , Chairman

Geo. R. Reilly , Member

John W. Lynch , Member

Richard Nevins , Member

_____ , Member

ATTEST: Dixwell L. Pierce , Secretary